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March 5, 1997

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: In the Matter of Federal-State Joint Board on Universal Service
CC Docket No. 96-45
Ex Parte Presentation

Dear Mr. Caton:

On March 5, 1997, Donn T. Wonnell, of Pacific Telecom, Inc. ("PTI"), and Nicholas W. Allard and Teresa D. Baer, of Latham & Watkins, met with Mindy Ginsburg and Jeanine Poltronieri of the Universal Service Branch to discuss universal service matters.

The enclosed materials were distributed during the meeting.

The original and two copies of this letter are enclosed.

Very truly yours,

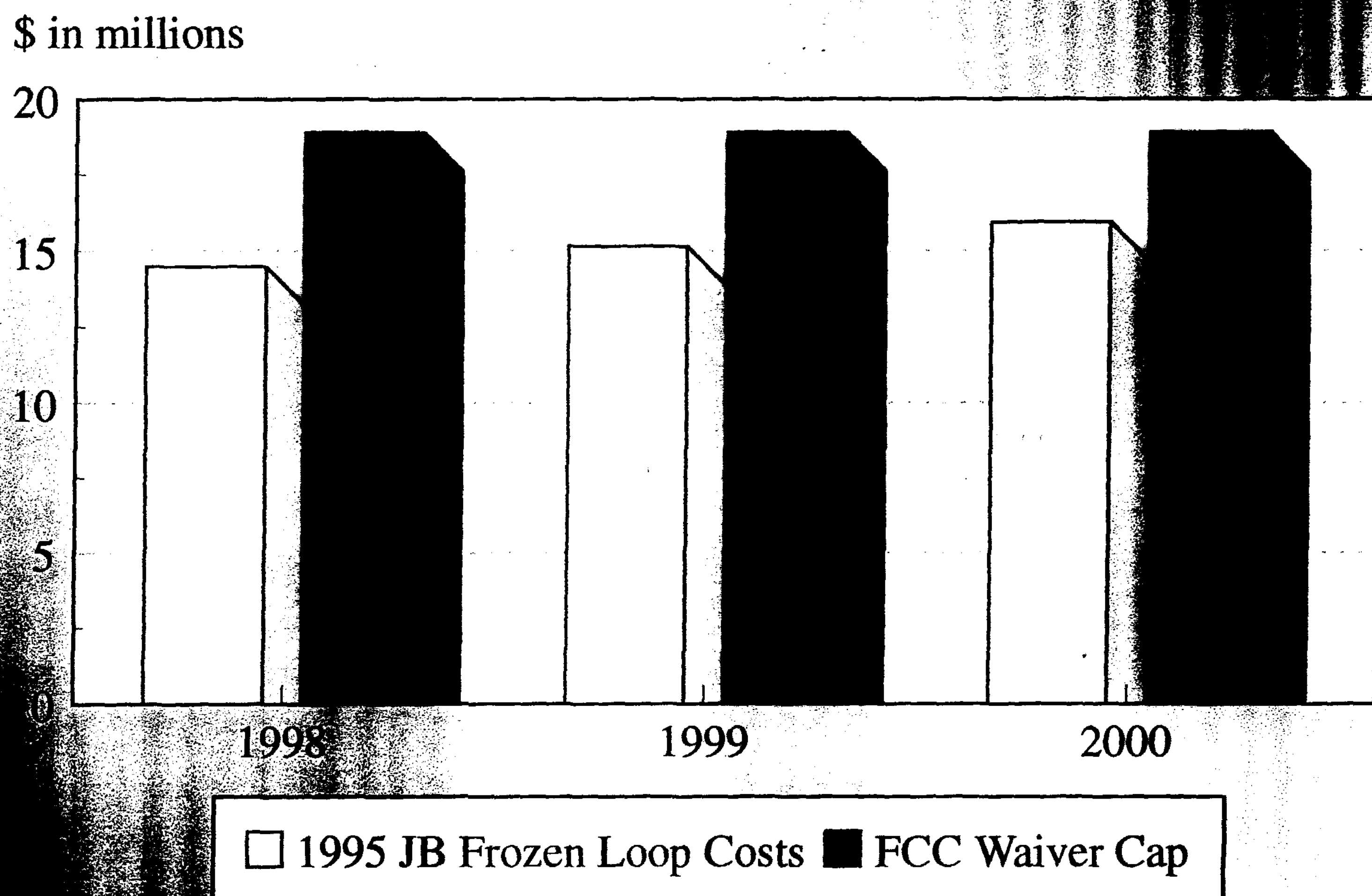
Teresa Baer

Teresa D. Baer

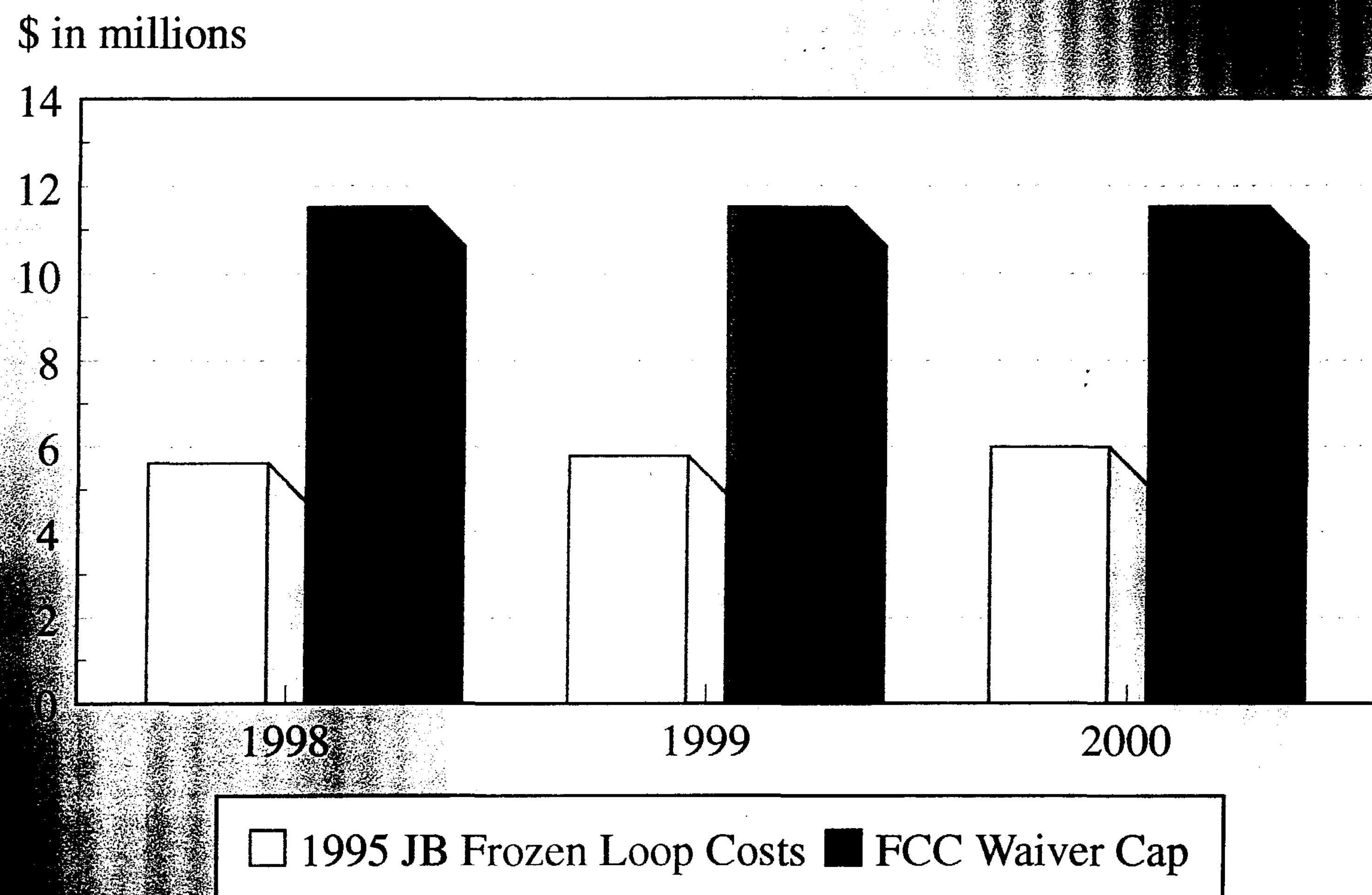
Enclosures
cc (w/out enclosures):
Mindy Ginsburg
Jeanine Poltronieri
Donn T. Wonnell

No. of Copies rec'd 0+1
List ABCDE

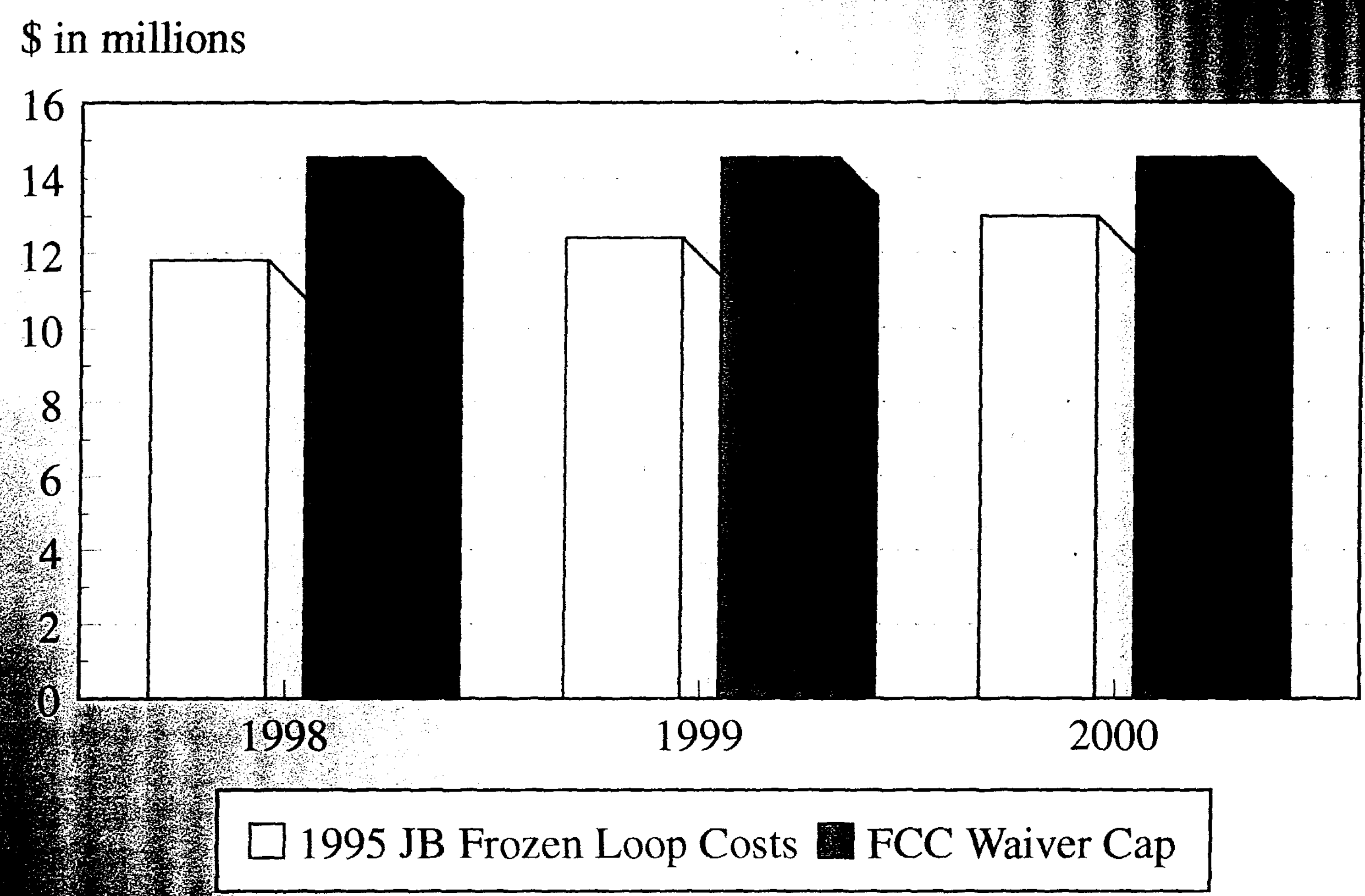
Universal Service Fund
(Colorado)



Universal Service Fund
(Oregon)



Universal Service Fund
(Washington)



Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of

US West Communications, Inc.
and
Eagle Telecommunications, Inc.

Joint Petition AAD 94-27
for Waiver of the
Definition of "Study Area" Contained
in Part 36, Appendix-Glossary
of the Commission's Rules

and

Eagle Telecommunications, Inc.

Petition for Waiver of Section 61.41(c)
of the Commission's Rules

MEMORANDUM OPINION AND ORDER

Adopted: January 4, 1995; **Released: January 5, 1995**

By the Commission:

I. INTRODUCTION

1. On February 2, 1994, US West Communications, Inc. ("US West") and Eagle Telecommunications, Inc./Colorado, d/b/a PTI Communications, Inc. ("PTI/Eagle") (collectively, "Petitioners") filed a joint petition for waiver ("Joint Petition") of the definition of "Study Area" contained in Part 36, Subpart H, Appendix-Glossary, of the Commission's rules. US West proposes to sell 43 Colorado telephone exchanges to PTI/Eagle. This waiver would allow US West to remove these 43 exchanges from its Colorado study area, and allow PTI/Eagle to add these exchanges to its Colorado study area. PTI/Eagle also seeks a waiver of Section 61.41(c) of the Commission's price cap rules to exempt it from the price cap "all or nothing" rule and to allow PTI/Eagle to operate as a cost company.[1]

2. On March 2, 1994, the Common Carrier Bureau ("Bureau") released a public notice soliciting comments on the joint petition for waiver.[2] Comments in support of the request were filed by the National Exchange Carrier Association, Inc. ("NECA") and the Colorado Public Utilities Commission ("Colorado PUC").[3] No party objected to Petitioners' waiver request. At the request of Bureau staff, Petitioners provided additional financial and cost data concerning the proposed transaction.[4] On June 15, 1994, US West submitted a copy of the Colorado PUC Order approving the transfer of the 43 exchanges to PTI/Eagle subject to several conditions.[5] In this Order, we grant Petitioners' study area waiver petition and PTI's petition for waiver of Section 61.41(c).

3. As more fully explained herein, we also set forth more specific guidance concerning one of the three factors we consider in evaluating study area waiver requests: adverse impact on the Universal Service Fund ("USF"). We shall apply the clarification delineated in this decision prospectively to waiver requests filed after the release of this Order.

II. BACKGROUND

4. US West provides telephone service in 14 states, including Colorado. In Colorado, it serves 2.2 million access lines and 146 exchanges. PTI/Eagle operates 8 exchanges that serve approximately 7,700 access lines in Colorado. PTI/Eagle proposes to purchase 43 Colorado exchanges from US West. US West's 43 exchanges serve approximately 48,000 access lines.[6] US West states that it initiated this sale to ensure that the 43 exchanges receive the most efficient network service upgrades in compliance with ser-

[1] Section 61.41(c) of the Commission's rules (the "all-or-nothing" rule) provides that when a non-price cap company acquires a price cap company, or any part thereof, the acquiring company shall become subject to price cap regulation. *See* 47 C.F.R. §61.41(c).

[2] Public Notice, 9 FCC Rcd 1018 (Com. Car. Bur. 1994).

[3] Reply Comments were filed by PTI/Eagle. On September 21, 1994, the Colorado PUC forwarded a letter to the Common Carrier Bureau requesting expeditious approval of the joint petition for study area waiver. Although these pleadings were filed late, we will treat this late filing as informal comments that will be considered in the interest of achieving a complete record. Letter from Robert J. Hix, Chairman, Colorado PUC, to Kathleen M.H. Wallman, Chief, Common Carrier Bureau, dated Sept. 21, 1994 (*ex parte* notification filed on Oct. 25, 1994).

[4] *Ex parte* letter from Aileen Piscotta, PTI, to William F. Caton, Acting Secretary, FCC dated June 29, 1994; *Ex parte* letter from Michael Crumling, US West, to William F. Caton, Acting Secretary, FCC dated Oct. 4, 1994 ("Oct. 4 Supplement"); *Ex parte* letter from Teresa Baer, PTI, to William F. Caton, Acting Secretary, FCC, dated Oct. 18, 1994; *Ex parte* letter from Brian Thomas, PTI, to William F. Caton, Acting Secretary, FCC dated Oct. 21, 1994. (Containing information originally forwarded to the FCC on July 27, 1994, and Sept. 23, 1994 ("Sept. 23 Supplement")).

[5] *Ex parte* letter from Mike Crumling, US West, to William F. Caton, Acting Secretary, FCC, dated Oct. 25, 1994 (Containing information originally forwarded to the FCC on June 15, 1994). *See also* Colorado Public Utilities Commission Order, Docket No. 93A-440T, adopted April 22, 1994 ("Colorado PUC Order"). The Colorado PUC approved the sale transaction subject to certain modifications that include: (i) a requirement that US West and PTI accelerate deployment of single-party service in their respective exchanges; (ii) a requirement that US West complete installation of Signalling System 7 ("SS7") in all remaining US West rural and urban exchanges by December 31, 1997; and (iii) that US West and PTI comply with certain accounting, depreciation, reporting, and other infrastructure development requirements.

[6] The following exchanges are part of the proposed sale and transfer between US West and PTI/Eagle: Akron, Otis, Wray, Yuma, Bristol Granada, Cheraw, Cheyenne Wells, Collbran,

vice standards mandated by the Colorado PUC.[7] PTI/Eagle states that it plans to complete a network modernization program that will replace three electro-mechanical switches, and substantially replace outside plant for more than 200 analog subscriber carrier systems that are currently in service. PTI/Eagle proposes to consolidate the 43 exchange areas into a new Colorado study area.

III. STUDY AREA WAIVER

5. A study area is a geographical segment of a carrier's telephone operations. Generally, a study area corresponds to the carrier's entire service territory within a state. Thus, carriers that operate in more than one state typically have one study area for each state, and carriers that operate in a single state have a single study area. Carriers perform jurisdictional separations at the study area level.[8] For jurisdictional separations purposes, the Commission adopted a rule freezing study area boundaries effective November 15, 1984.[9] If a carrier wishes to sell an exchange to another carrier, it must apply to the Commission for a waiver of the rule because the sale of an exchange would have the effect of changing the study area boundaries.[10] The Commission employs a three-prong standard in evaluating petitions seeking such a waiver: first, that the change not affect adversely the USF support program;[11] second, that the state commission having regulatory authority does not object to the change;[12] and finally, that the public interest supports grant of the waiver.[13]

Petition

6. US West seeks a waiver to remove the 43 exchanges it is selling to PTI/Eagle from its Colorado study area.[14] PTI/Eagle also seeks a waiver to include these 43 exchanges in its existing Colorado study area. Petitioners argue that the public interest requires that the Commission grant the requested waivers. In particular, PTI claims that its proposed modernization and upgrade will improve service quality. In addition, Petitioners state that changing their study area boundaries would not be in conflict with the Commission's original policy that froze study area boundaries because of concern that telephone holding companies would establish high cost exchanges within their existing service territory as separate but subsidiary companies to maximize high cost support. Petitioners argue that there is no connection or relationship (e.g., stock ownership, common directors) between the parties involved in this transaction.[15]

7. Petitioners estimate that grant of the study area waiver would increase annual support payments from the USF in connection with these exchanges by approximately $18.1 million.[16] US West states that it has been receiving no USF support before the sale of the 43 exchanges, and will receive none afterwards, because the average cost per loop of its Colorado study area is substantially below the national eligibility threshold for USF support.[17] PTI estimates that its USF draw would increase from approximately $820,000 to $18.9 million after it purchases and upgrades the 43 exchanges. It estimates that, of the $18.1 million USF increase, $14.5 million would be attributable to the

Creed, Fowler, Holly, Ignacio, La Jara, La Veta, Lamar, Manassa, Manzanola, Mesa, Norwood, Ordway, Rocky Ford, Stratton, Two Buttes, Walden, Walsh, Weston, Antonito, Burlington, Campo, Center, Dolores, La Junta, Las Animas, Rangely, Saguache, Springfield, Branson, Gardner, Lake George, Maybell, Red Feather Lakes, San Luis, and Westcliffe. The Rangely and Lamar exchange have two wire centers. The Petition thus seeks waiver for 43 exchanges that contain 45 wire centers.

[7] Joint Petition at 2. The Colorado PUC adopted a rule that requires all multi-party lines to be upgraded to one-party service by the end of 1994. *See* Colorado Commission's Rules Regulating Telecommunications Service Providers and Telephone Utilities, 4 CCR 723-2 ("Rule 17"). US West received a waiver of this requirement from the Colorado PUC until December 31, 1998 for upgrades of some of its exchanges. In light of this pending transaction and because PTI offered to complete all service upgrades necessary for single-party service at all 43 exchanges by the end of 1995, the Colorado PUC has granted PTI a partial waiver of its rule requiring single-service availability until December 31, 1995. *See also* Colorado PUC Order.

[8] The phrase "jurisdictional separations," or "separations," refers to the process of dividing costs, revenues, and expenses between a carrier's state and interstate operations. *See generally* 47 C.F.R. §§ 36.1-36.741.

[9] 47 C.F.R., Part 36, Appendix-Glossary, definition of "Study Area" (1993). *See* MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket Nos. 78-72 and 80-286, 49 Fed. Reg. 48325 (Dec. 12, 1984) (*1984 Joint Board Recommendation*), adopted by the Commission, 50 Fed. Reg. 939 (Jan. 8, 1985) (*1985 Order Adopting Recommendations*). *See also* Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, Notice of Proposed Rulemaking, 5 FCC Rcd 5974 (1990) (*Study Area Notice*).

[10] 47 C.F.R. Part 36, Appendix-Glossary. *See also* 47 C.F.R. § 1.3.

[11] *See Joint Board Recommendation*, 49 Fed. Reg. at 48337, para. 65. The Commission created the USF to preserve and promote universal telephone service. *See* Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, 96 FCC 2d 781 (1984). The USF allows LECs with high cost loop costs to allocate a portion of those costs to the interstate jurisdiction thus allowing the states to establish lower local exchange rates in those service areas. To qualify for USF support, a LEC's total company unseparated loop costs must exceed 115 percent of the nationwide average for such costs. *See* 47 C.F.R. §36.631.

[12] *See generally* Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, Notice of Proposed Rulemaking, 5 FCC Rcd 5974 (1990) ("*Study Area Notice*"). In that notice the Commission described the factors that led to the present restriction on study area changes.

[13] *Memorandum Opinion and Order*, 9 FCC Rcd 3197 (Com. Car. Bur. 1994).

[14] US West states that it will make a permanent downward adjustment to its price cap indices to reflect the sale of these exchanges. *Ex parte* letter from Laura D. Ford, US West, to Richard Metzger, Acting Chief, Common Carrier Bureau, FCC, dated June 23, 1994 ("US West Letter").

[15] Joint Petition at 5-6.

[16] Joint Petition at 9-10.

[17] USF support is based on the average cost per loop in the study area, compared to the national average cost per loop. The study area cost per loop must be at least 115% of the national average cost per loop in order to qualify for USF support. The national average cost per loop is currently $239, so the eligibility threshold for USF support is $275, *i.e.*, $239 x 115% = $275. *See* 47 C.F.R. § 36.631, National Exchange Carrier Association, Inc., 1993 USF Report Section 1 at 3.

acquisition and $3.6 million would be attributable to the upgrading of the facilities.[18] Petitioners contend that their request is consistent with the original purposes of the USF and that the transfer of the 43 exchanges will not adversely affect the USF in any material way.[19]

8. Petitioners contend that existing network facilities in the 43 sale exchanges will require substantial plant construction in order to bring them in line with current service standards. For example, the petitioners state that the 43 exchanges are burdened with 7,000 multi-party lines, 23,000,000 feet of open wire, and more than 200 analog subscriber carrier systems.[20] Petitioners state that the Colorado PUC has adopted a rule that all multi-party lines be upgraded to single-party service by the end of 1994, and that in light of the impending sale, PTI has been granted an extension until the end of 1995 to upgrade all 43 exchanges to single-party service.[21] PTI/Eagle claims it has already accomplished one-party upgrades in four wire centers.[22] Petitioners state that service upgrades in the remaining wire centers would be accomplished at a much faster pace than would have been accomplished absent the sales agreement between US West and PTI/Eagle.[23] PTI/Eagle asserts that it is committed to upgrade all customers in the purchased exchanges to single-party service.[24]

9. Petitioners also assert that there are public interest benefits associated with the sale and transfer of the 43 exchanges. They maintain that the staff of the Colorado Commission and the Colorado Office of the Consumer Counsel have found that the proposed transaction is in the public interest because: (i) US West's customers in both the non-sale exchanges and sale exchanges will receive upgraded single party service faster under the proposed sale than without such a transaction; (ii) PTI/Eagle will improve service quality in the sale exchanges; and (iii) in comparison to US West, PTI/Eagle will dedicate more service personnel resources to the sale exchanges resulting in greater responsiveness to the customers.[25] In addition, Petitioners argue that, after the transfer, the 43 exchanges will be served by a company that specializes in rural service and is committed to ensuring that such service is provided on a fully upgraded basis.[26]

Discussion

10. *USF Impact.* For jurisdictional separations purposes, the Commission adopted a rule freezing all local exchange carrier ("LEC") study area boundaries as they existed on November 15, 1984.[27] The Commission took that action, in part, to ensure that LECs do not set up high cost exchanges within their existing service territories as separate study areas to maximize high cost support.[28]

11. As described in paragraph seven, *supra*, Petitioners indicate that the proposed transaction would cause an increase in the USF support payments received by the 43 sale exchanges. Petitioners estimate that USF support payments for the 48,000 access lines involved in this transaction would increase by $18.1 million annually, which translates into an increase in the annual per-loop USF assistance from zero to $377. The record shows that approximately $14.5 million of this $18.1 million annual increase would occur simply by virtue of the change in ownership and redefinition of US West's study area for the 43 sale exchanges, regardless of any efforts that PTI may subsequently undertake to improve telephone service.[29] The $18.1 million increase in USF support represents approximately 2.5 percent of the $725 million USF fund for 1994.

12. In addressing prior requests for waiver of study area boundaries related to the sales of exchanges, the Bureau noted the Commission's concern about the potential impact of such transfers on the size of the USF.[30] Our concern has been mitigated to some extent by our adoption of an indexed cap on the USF for the next 13 months, pursuant to a recommendation of the Joint Board.[31] The instant waiver request, however, presents the first case in which grant of the request will have a significant impact on the support that high cost LECs currently receiving USF support would, or could, draw in the future. We have not had occasion previously to apply the "adverse impact" standard in the context of transactions that would have a significant impact on the draws of other LECs from the USF.

13. Because of the indexed cap on the aggregate USF, an increase in the draw of any USF recipient necessarily reduces the amounts that other LECs receive from the USF. In the case of the proposed transfer to PTI/Eagle, the projected increase of approximately $18.1 million in the USF draw of PTI/Eagle will lower the USF support available for other high cost LECs by the same amount. Specifically, we calculate that if the impact on the USF caused by the US West/PTI transaction were to take effect in 1995, it

[18] Joint Petition at Appendix B and October 4 supplement.
[19] *Id.* at 9-10.
[20] *Id.* at 2.
[21] *Id. See also* Colorado PUC Order, cited *supra* at n.5.
[22] Joint Petition at 3.
[23] *Id.* at 9.
[24] *Id.* at 4. PTI claims that its voice grade service would include touch tone capabilities and would provide at least 4800 baud for operation of a FAX or computer modem.
[25] *Id.* at 8.
[26] *Id.*
[27] *See* citations at n.9, *supra*.
[28] *See 1985 Order Adopting Recommendations*, 50 Fed. Reg. 939.
[29] *See* Oct. 4 Supplement.
[30] *See, e.g.*, Nevada Bell and Oregon-Idaho Utilities, Inc. Joint Petition for Waiver of the Definition of "Study Area" Contained in Part 36, Appendix-Glossary, of the Commission Rules, 9 FCC Rcd 5238, para. 14 (1994).
[31] *See generally* Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, 9 FCC Rcd 334 (1993) ("Recommend Decision"), *adopted* by the Commission, 9 FCC Rcd 303 ("Interim Order"). The Commission adopted the Joint Board's recommendation for an indexed cap on the USF. *See id.* The Joint Board recommended, and the Commission adopted, interim rules that limit the rate of growth of the USF to the rate of growth in the total number of working loops nationwide. *Id.* That rate of growth has generally ranged from two percent to four percent per year. *Id.* This moderate growth rate will allow the USF to continue to provide adequate support to carriers serving high-cost areas, while preventing excessive increases in the USF. *Id.* In its *Interim Order*, the Commission also expressed its intention to review the USF rules to determine whether permanent changes are necessary. *Interim Order* at 303. We have undertaken that review. Amendment of Part 36 of the Commission's Rules and Establish of a Joint Board, *Notice of Inquiry*, FCC 94-199 (released August 30, 1994).

would reduce the USF receipts of small LECs[32] by more than $7.0 million. Other study area waiver requests, with similar potential for causing reductions in the USF receipts of small LECs, also are pending before us.[33] We are concerned that this trend could continue, with the result that substantial adverse effects upon recipients of the USF will occur if additional study area waivers are filed and granted, causing further reductions among the existing recipients of the USF.

14. We are therefore concerned about the aggregate effect on the USF of study area waiver requests. This concern, in light of the USF cap, leads us to conclude that we need to provide more specific guidance to be used in evaluating whether grant of a waiver request would result in undue adverse effect upon the USF. In light of the increasing number of study area waiver requests with significant potential for USF effect, we believe that no waiver should cause an annual aggregate shift in USF assistance in an amount equal to or greater than one percent of the total USF, unless the parties can demonstrate extraordinary public interest benefit. In order to prevent carriers from evading this limitation by disaggregating a single large sale of exchanges into a series of smaller transactions that in the aggregate have the same effect as the USF, the "one percent" condition must apply to all study area waivers granted to either carrier, as a purchaser or seller, pending completion of the current review of the USF program.[34]

15. We recognize that we might have chosen another criterion, including a different percentage, for evaluating whether the proposed transaction would adversely affect the USF, contrary to the public interest. The criterion we have selected will ensure that, during our ongoing review of the USF program, transfers of exchanges do not cumulatively lead to substantial, unexpected changes in USF support needed to maintain local rates at reasonable levels. We believe that this approach strikes a reasonable balance between the need to maintain adequate USF assistance to carriers serving high cost areas and our desire to avoid interfering with private business transactions. Our "adverse impact" standard, as clarified herein, also preserves the opportunity for parties to a particular transaction to show that the specific circumstances of the proposed transfer justify unconditional grant of the requested waiver.

16. In the instant case, however, we note that the parties negotiated this complex transaction and filed their petition for waiver based on their reasonable expectations that the transfer would meet the more general standard that the Commission has enunciated and applied in evaluating prior study area waiver requests. The same can be said of other requests for study area waivers currently pending before the Commission. In light of the likely degree of burden which application of the "one percent" guideline would impose on Petitioners and other parties with pending waiver applications, as well as their efforts in formulating a transaction that they believed would satisfy our existing precedents, it would be inequitable to apply the "one percent" guideline in these cases. Similarly, in light of these unique circumstances, we do not believe that the public interest would be served by denying the waiver request or by significantly limiting the impact of the proposed transaction on the USF. Applying the more general standard, the proposed transaction would not result in adverse impact on the USF.

17. We shall apply the "one percent" guideline for USF impact on a prospective basis only. Study area waiver requests filed after the release date of this order shall be subject to the condition that the transfer at issue and any other transfers involving either carrier, as a purchaser or seller, may not cause a shift in USF assistance in an amount equal to or greater than one percent of the total USF for the year in which the waiver request is submitted, unless the parties can demonstrate extraordinary public interest considerations that would warrant removal of this condition. For purposes of applying this guideline, the USF effect for the year must be computed on an annualized basis.

18. *State Commission Approval.* The Colorado PUC has approved the transaction and the petition is not opposed by any party. Moreover, the record also contains the Colorado PUC's support for the proposed sale and transfer of the 43 exchanges.[35] Accordingly, the second criterion for granting a study area waiver has been satisfied.

19. *Public Interest Findings.* The record demonstrates that under the Petitioners' proposal, existing and potential customers in the 43 sale exchanges will be better served by PTI/Eagle than by US West. In addition, Petitioners state that under the proposed transfer, PTI/Eagle would upgrade existing switching technology and commit substantial resources to replace and modernize the outside plant that serve these exchanges. PTI/Eagle's commitments to upgrade and modernize the facilities serving the 43 exchanges demonstrate significant public interest benefit from the proposed transactions.

20. *Conclusion.* Based on the record before us, we conclude that the three existing criteria for granting a study area waiver have been met in this case and that the waiver request should be granted. Nonetheless, while we have no reason to question Petitioners' estimates of USF impact, we are concerned that the waiver could lower the support received by other USF recipients by even more than $18.1 million if the Petitioners' estimates were to prove too low. In several past cases, the actual USF impact has risen far above the amount petitioners suggested when they sought study area waivers.[36] We therefore grant the requested study

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[32] Here we have defined small LECs as all LECs other than those owned by the Regional Bell Holding Companies, GTE, and Sprint.

[33] We note, for example, that US West has several study area waiver petitions pending before the Bureau that would draw down the USF available for other high cost carriers by approximately $12,000,000. *See, e.g.*, US West/Telephone Utilities of E. Oregon, Inc., Petition for Waiver of the Definition of Study Area, AAD 94-69 (filed on June 9, 1994); US West/Telephone Utilities of Washington Inc., Petition for Waiver of the Definition of Study Area, AAD 94-74 (filed on June, 30, 1994).

[34] In this context, the term "carrier" includes all affiliated carriers (*i. e.*, those carriers that are in common "control," as the term "control" is defined in Section 32.9000 of the Commission's rules, 47 C.F.R. § 32.9000).

[35] Letter from Robert J. Hix, Chairman, Colorado PUC, to Kathleen M.H. Wallman, Chief, Common Carrier Bureau, dated Sept. 21, 1994 (*ex parte* notification filed on Oct. 25, 1994).

[36] *See* Delta Telephone Company, 5 FCC Rcd 7100 (1990) (USF support grew from $82,500 in 1991 to $396,910 in 1993) US West and Gila River Telecommunications, Inc., 7 FCC Rcd 2161 (1992) (USF support escalated from $169,155 in 1992 to $492,300 in 1993).

area waiver, subject to the condition that any USF increase associated with the sale of the 43 US West Colorado exchanges to PTI/Eagle may not exceed $18.1 million per calendar year.

IV. PRICE CAPS WAIVER

Petition

21. PTI/Eagle also seeks waiver of the Commission's rules governing the acquisition of price cap companies by non-price cap companies. PTI/Eagle seeks a waiver of rule Section 61.41(c) to allow it to operate as a cost company, rather than a price cap company, despite its acquisition of existing price cap exchanges.

22. Section 61.41(c) of the Commission's rules provides that when a non-price cap company acquires a price cap company or any part thereof, the acquiring company shall become subject to price cap regulation.[37] Under this rule, PTI/Eagle's acquisition of the 43 US West exchanges obligates it to exit the NECA pools and become subject to price cap regulation. PTI/Eagle argues that the rule's application in this instance is contrary to the public interest and would not serve the purposes for which the rule was adopted.[38] PTI/Eagle contends that: (i) the Commission's concern to prevent cost shifting between affiliates is not at issue here; and (ii) the concern to prevent a company from using acquisitions and choosing a regulatory system to "game" the system, is also not raised by the facts in this petition.

Discussion

23. The Commission's rules governing mergers and acquisitions provide that when a non-price cap company and a price cap company merge, or when one company acquires the other, the resulting company must comply with price cap regulation within a year of the transaction.[39] The rationale for this rule is stated in the *LEC Price Cap Reconsideration Order*. First, in the absence of the rule, a company might attempt to shift costs from its price cap affiliate to its non-price cap affiliate, allowing the rate of return affiliate to earn more (because of its greater revenue requirement) without affecting the earnings of the price cap affiliate (*i.e.*, without triggering the sharing mechanism). Second, if a LEC were allowed to go back and forth between rate of return regulation and price cap regulation, it could "game the system" by, for example, building up a large rate base under rate of return regulation, then opting for price caps again and cutting its costs to an efficient level.[40] The Commission stated, however, that "in some cases, the efficiencies created by the purchase and sale of [a few] exchanges may outweigh the threat of "gaming the system." Such cases might justify narrow waiver of the all-or-nothing rule.[41]

24. We find that there is good cause to grant PTI/Eagle a waiver of the all-or-nothing rule. The first concern cited by the Commission, cost-shifting between affiliates, is not applicable in this case, because PTI/Eagle is not seeking to maintain separate affiliates under different systems of regulation. The second concern underlying the rule, allowing a company to "game the system," could be a source of concern because US West's sale of these high-cost exchanges will alter the network costs that comprise the basis for US West's current price caps.[42] US West has stated, however, that it will reduce its interstate revenue requirements to reflect the sale of the 43 exchanges to PTI/Eagle, and then adjust its price cap indices accordingly.[43] Grant of this waiver is conditioned on US West's compliance with this representation.

25. For the reasons described herein, we grant a waiver of the all-or-nothing rule for PTI/Eagle, subject to US West's adjusting its price cap indices as described in paragraph 24, above. For the present, we will continue to regulate PTI/Eagle under rate of return. Because we are waiving Section 61.41, PTI/Eagle need not withdraw from the NECA pools. We note that as with any other rate of return carrier, PTI/Eagle is free to elect price cap regulation in the future, provided it withdraws from the NECA pools.

V. ORDERING CLAUSES

26. Accordingly, IT IS ORDERED, pursuant to Sections 1, 4(i), and 201-202 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 154(i), and 201-202, and Rule 1.3 of the Commission's rules, 47 C.F.R. §1.3 (1993), that the Joint Petition of US West Communications, Inc. and Eagle Telecommunications, Inc. for waiver of Part 36, Appendix-Glossary, of the Commission's Rules, 47 C.F.R. Part 36 Appendix-Glossary, IS GRANTED, subject to the condition stated in paragraph 20 of this Order.

27. IT IS FURTHER ORDERED that the Petition of Eagle Telecommunications, Inc. for waiver of Section 61.41(c) of the Commission's Rules, 47 C.F.R. § 61.41(c), IS GRANTED, subject to the condition stated in paragraph 24 of this Order.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton
Acting Secretary

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[37] 47 C.F.R. § 61.41(c)(2).

[38] Joint Petition at 12.

[39] Second Report and Order, 5 FCC Rcd 6786, 6821 (1990) and Erratum, 5 FCC Rcd 7664 (1990) (*LEC Price Cap Order*), *modified on recon.* 6 FCC Rcd 2637 (1991) (*LEC Price Cap Reconsideration Order*), *petitions for further recon. dismissed*, 6 FCC Rcd 7482 (1991), *aff'd, National Rural Telecom Assoc. v. FCC*, 988 F.2d 174 (D.C. Cir. 1993), *further modification on recon.*, 6 FCC Rcd 4524 (1991) (*ONA Part 69 Order*), *second further recon.*, 7 FCC Rcd 5235 (1992).

[40] *LEC Price Cap Reconsideration Order*, 6 FCC Rcd 2637, 2706.

[41] *Id.* at 2706, para. 149, n.207.

[42] The generic issue that is posed more generally by this set of circumstances is being considered by the Commission in CC Docket No. 94-1. The Commission may require automatic adjustment to price capped rates to reflect the costs that are being removed from price cap regulation after reviewing the record in that docket.

[43] US West Letter, cited *supra* at n.15.

(Decision No. C94-206)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * *

IN THE MATTER OF THE JOINT APPLICATION OF U S WEST COMMUNICATIONS, INC., AND EAGLE COMMUNICATIONS, INC., D/B/A PTI COMMUNICATIONS, INC., FOR AUTHORITY TO TRANSFER CERTAIN TELEPHONE EXCHANGES, OPERATIONS AND BUSINESS OF U S WEST COMMUNICATIONS, INC., TO EAGLE TELECOMMUNICATIONS, INC., D/B/A PTI COMMUNICATIONS, INC., A WHOLLY OWNED SUBSIDIARY OF PACIFIC TELECOM, INC.	)	DOCKET NO. 93A-440T

COMMISSION ORDER

Mailed Date: February 28, 1994
Adopted Date: February 17, 1994

or "below-the-line" accounts for both ratemaking purposes and for purposes of Alternative Form of Regulation ("AFOR") sharing. Finally, the Commission declares that the rate base acquired by PTI, as adjusted at the time of closing, is recoverable and otherwise recognized for ratemaking purposes.

The Commission will approve the Stipulation entered into by some of the parties to this proceeding, but with certain modifications. The Commission will order the withdrawal of U S WEST's Advice Letter No. 2425, require the acceleration of a number of service regrades for regrading multi-party customers by both applicants, the provision of Signaling System 7 ("SS7") in all remaining U S WEST rural and urban exchanges, and eliminate or modify certain elements of the Stipulation entered into by some of the parties.

II. PROCEDURAL BACKGROUND

U S WEST and PTI filed the Application on August 30, 1993. Their direct testimony was filed with the Application. The Commission issued notice of the Application pursuant to Commission Rule 71[3] on September 1, 1993. Intervention was granted to the trial Staff of the Commission ("Staff"), Colorado Office of Consumer Counsel ("OCC"), American Telephone & Telegraph Company of the Rocky Mountain States ("AT&T"), MCI Telecommunications Corporation ("MCI"), Southeast Colorado Power Association

[3] Rule 71 was subsequently modified and is now found in Rule 70, 4 CCR 723-1.

The sale ameliorates the effect of these competing forces on captive customers in many ways. First, the sale severs the competitive pressures U S WEST perceives it faces in the urban areas from increasing customer demand for investment in rural exchanges by placing responsibility for these rural exchanges on the shoulders of a rural telephone utility provider dedicated to the provision of telephone service in rural areas. PTI is a local exchange company that owns and operates several rural exchanges. While PTI does serve some smaller urban areas, they are not of the scale served by U S WEST. Thus, PTI is not as dramatically torn between serving urban areas, on the one hand, and, on the other hand, providing universal service to rural areas.

Second, PTI has developed an expertise in serving rural areas. The unrebutted record in this proceeding establishes that PTI has an established record of providing quality service to rural service territories. In its existing operations in Eagle, Colorado, PTI has demonstrated its willingness to devote the necessary capital to bring that area single-party service with 100 percent digital switches. PTI's trouble reports and repeat trouble reports are better than comparable numbers for U S WEST.[11] The Commission believes PTI's expertise and commitment to rural exchanges will benefit the 45 rural exchanges in Colorado.

[11] See Integrated Joint Application, Tab 55(c)(13)(D), pp. 001629 - 001630.

Third, the sale will maintain, and in fact accelerate, the scheduled regrades of multi-party lines to single-party now occurring under RFIP II. This Commission made it clear at the outset of this docket that any sale of rural exchanges should not disrupt on-going RFIP II regrades of facilities in the exchanges to be sold.[12] The Stipulation, at a minimum, maintains this schedule, and in some cases improves on the current RFIP II schedule. In addition, PTI agreed during the hearing to accelerate even further regrades that were scheduled to occur in 1996 so that all regrades in the 45 exchanges will be finished by December 31, 1995. The monitoring requirement in the Stipulation will ensure that these up-grades are timely made.[13] The Commission is encouraged by PTI's commitment here to accelerate these regrades. This type of response to customer needs is essential to building public acceptance and trust in this transaction.

The Application will also allow U S WEST to accelerate regrades in the RFIP II program for non-sale exchange areas. U S WEST's current plans for regrades calls for their completion by the end of 1996. U S WEST stated in prefiled testimony that because of the sale it will be able to finish

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[12] One of the conditions set forth in U S WEST's Memorandum of Understanding was that the offeror must be willing and able to work on upgrades during the pendency of the application before this Commission pursuant to a side agreement known as the Statement of Work.

[13] See Stipulation, p. 14, para. 25.

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * *

IN THE MATTER OF THE JOINT APPLICATION OF U S WEST COMMUNICATIONS, INC. AND EAGLE TELECOMMUNICATIONS, INC./ COLORADO D/B/A PTI COMMUNICATIONS, INC. FOR AUTHORITY TO TRANSFER CERTAIN TELEPHONE EXCHANGES, OPERATIONS AND BUSINESS OF U S WEST COMMUNICATIONS, INC. TO EAGLE TELECOMMUNICATIONS, INC./ COLORADO D/B/A PTI COMMUNICATIONS, INC., A WHOLLY OWNED SUBSIDIARY OF PACIFIC TELECOM, INC.	)	APPLICATION NO. 93A-440T

STIPULATION AND SETTLEMENT AGREEMENT

U S WEST Communications, Inc. ("USWC"), Eagle Telecommunications, Inc./Colorado, a wholly owned subsidiary of Pacific Telecom, Inc., d/b/a PTI Communications, Inc. ("PTI/Eagle"), Staff of the Colorado Public Utilities Commission ("Staff") and Colorado Office of Consumer Counsel ("OCC") (collectively referred to as the "Parties"), respectfully submit this Stipulation and Settlement Agreement ("Agreement") for approval by the Colorado Public Utilities Commission (the "Commission"), pursuant to Rule 83(a) of the Commission Rules of Practice and Procedure:

RECITALS

WHEREAS, USWC and PTI/Eagle have entered into an agreement for Purchase and Sale of Exchanges dated August 30, 1993, (the "Sale Agreement");

referenced Certificates of Public Convenience and Necessity as part of this proceeding.

24. The Parties acknowledge that the PTI/Eagle construction schedule will achieve modernization in the Exchanges at a faster pace than would be achievable without the Sale Agreement. Therefore, the Parties support and request the issuance of a partial waiver of the application of Rule 17 - Basic Telephone Service standard allowing until year end 1996 for conversion to single party service in the following exchanges:

Antonito	Gardner	Red Feather Lakes
Branson	La Junta	Saguache
Burlington	Lake George	San Luis
Campo	Las Animas	Springfield
Center	Maybell	Westcliffe
Delores	Rangely	

25. PTI/Eagle agrees to submit to the Commission detailed quarterly progress reports concerning conversion to single party service in the Exchanges.

26. Staff and the OCC agree that the PTI/Eagle adoption of USWC rates for services in the Exchanges constitutes a reasonable level of initial rates for PTI/Eagle operations. PTI/Eagle agrees to submit to Staff and OCC quarterly results of operations intended to facilitate monitoring of the continued appropriateness of PTI/Eagle revenue levels ("Monitoring Reports"). The format of the Monitoring Reports shall be agreed upon by Staff, OCC, and PTI/Eagle within 14 days of the date of the signing of this Agreement. Once agreed upon, the format of the Monitoring Report shall be filed as an addendum to this Agreement.

COMMUNICATIONS DAILY, MARCH 4, 1997

PTI Communications said it began eliminating mileage charges from Colo. customers' monthly phone bills March 1. Change, approved by Colo. PUC, will result in saving for more than 14,000 PTI customers who live outside of base rate areas. Mileage charges are assessed against customers who live more than 1.5 miles from central office. Residential customers outside base rate area pay extra $5-$20, depending on which of 3 zones they live in, while businesses pay additional $7.50-$25. When PUC approved sale of 45 U S West rural phone exchanges to PTI in 1995, one condition was that PTI eliminate mileage charges when it began receiving full funding from federal Universal Service Fund (USF). PTI reached its full USF annual funding level of $16.7 million in Feb. and filed application with PUC to eliminate mileage charges.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
US West Communications, Inc.,	)	
Pacific Telecom, Inc. and Telephone	)	
Utilities of Washington, Inc.	)	DA 95-1787
	)	
Joint Petition for Waiver of Section 61.41(c)(2)	)	AAD 94-74
and the Definition of "Study Area"	)	
Contained in the Part 36 Appendix-Glossary	)	
of the Commission's Rules	)	

MEMORANDUM OPINION AND ORDER

Adopted: August 11, 1995 Released: August 11, 1995

By the Chief, Accounting and Audits Division:

I. INTRODUCTION

1. On June 30, 1994, US West Communications, Inc. ("US West"), Pacific Telecom, Inc. ("PTI") and Telephone Utilities of Washington, Inc. ("Telephone Utilities") (collectively, "Petitioners") filed a joint petition for waiver ("Joint Petition") of two commission rules. US West and PTI both seek a waiver of the definition of "Study Area" contained in the Part 36 Appendix-Glossary of the Commission's rules. That definition constitutes a rule freezing all study area boundaries. The requested waivers would allow US West and PTI to alter the boundaries of their Washington study areas when transferring 28 telephone exchanges from US West to PTI.[1] In addition, PTI and its wholly owned subsidiary, Telephone Utilities, seek waivers of the price cap rule contained in Section 61.41(c)(2) of the Commission's rules.[2] That rule requires non-price cap companies--and the telephone companies with which they are affiliated--to become subject to price cap regulation after acquiring a price cap company or any part thereof. The requested waiver would permit Telephone Utilities and the other affiliates of PTI to remain under rate-of-return regulation after Telephone Utilities acquires the 28 exchanges which currently are under price cap regulation.

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[1] For ease of presentation, we refer to the transferred properties as "28 exchanges" although PTI actually proposes to acquire 27 exchanges and a portion of a 28th exchange.

[2] PTI owns two operating telephone companies in Washington: Telephone Utilities of Washington, Inc. and Inter Island Telephone Company. Both companies operate under the name PTI Communications, Inc. and share a single study area.

2. On July 22, 1994, the Common Carrier Bureau ("Bureau") released a public notice soliciting comments on the Joint Petition.[3] On August 15, 1994, the Bureau received comments supporting the Joint Petition from two parties: the National Exchange Carrier Association, Inc. ("NECA") and the United States Telephone Association ("USTA"). At the request of Bureau staff, Petitioners provided additional financial and cost data concerning the Joint Petition.[4] In this Order, we find that the public interest would be served by allowing PTI and US West to alter their study area boundaries and allowing PTI and Telephone Utilities to continue operating under rate-of-return regulation after acquiring the 28 exchanges. We therefore grant the Joint Petition, as conditioned and explained more fully below.

II. STUDY AREA WAIVERS

3. ***Background.*** A study area is a geographical segment of a carrier's telephone operations. Generally, a study area corresponds to a carrier's entire service territory within a state. Thus, carriers operating in more than one state typically have one study area for each state, and carriers operating in a single state typically have a single study area. Study area boundaries are important primarily because carriers perform jurisdictional separations at the study area level.[5] For jurisdictional separations purposes, the Commission froze all study area boundaries effective November 15, 1984.[6] The Commission took that action primarily to ensure that local exchange carriers ("LECs") do not set up high-cost exchanges within their existing service territories as separate study areas to maximize high-cost payments.[7] The study area freeze also prevents LECs from transferring exchanges among existing study areas for the purpose of increasing interstate

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[3] Public Notice, 9 FCC Rcd 3437 (Com. Car. Bur. 1994).

[4] Letter from Lawrence Sarjeant, US West, to Kathleen Wallman, Chief, Common Carrier Bureau, FCC, dated Jan. 24, 1995 ("US West Jan. 24 Letter"); letter from Brian D. Thomas, Pacific Telecom, Inc., to Adrian Wright, Accounting & Audits Div., FCC, dated May 2, 1995 ("PTI May 2 Letter"); letter from Michael Crumling, US West, to William Caton, Acting Secretary, FCC, dated June 12, 1995 ("US West June 12 Letter"); letter from Teresa Baer, Latham & Watkins, to Charles Needy, Accounting & Audits Div., FCC, dated Aug. 3, 1995 ("PTI Aug. 3 Letter"); letter from Teresa Baer, Latham & Watkins, to Charles Needy, Accounting & Audits Div., FCC, dated Aug. 11, 1995 ("PTI Aug. 11 Letter").

[5] The phrase "jurisdictional separations," or "separations," refers to the process of dividing costs and revenues between a carrier's state and interstate operations. *See generally* 47 C.F.R. §§ 36.1 - 36.741.

[6] 47 C.F.R., Part 36, Appendix-Glossary, definition of "Study Area" (1993). *See* MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket Nos. 78-72 and 80-286, 49 Fed. Reg. 48325 (Dec. 12, 1984) (*1984 Joint Board Recommended Decision*), adopted by the Commission, 50 Fed. Reg. 939 (Jan. 8, 1985) (*1985 Order Adopting Recommendation*). *See also* Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, Notice of Proposed Rulemaking, 5 FCC Rcd 5974 (1990) (*Study Area Notice*).

[7] *See 1985 Order Adopting Recommendation*, 50 Fed. Reg. 939, 940. *Also see 1984 Joint Board Recommended Decision*, 49 Fed. Reg. 48325, 48337.

revenue requirements and compensation. A LEC must apply to the Commission for a waiver of the frozen study area rule if the LEC wishes to sell an exchange to another carrier and if that transaction would have the effect of changing the study area boundaries of either carrier.[8]

4. Waiver of Commission rules is appropriate only if special circumstances warrant deviation from the general rule[9] and such a deviation will serve the public interest.[10] In evaluating petitions seeking a waiver of the rule freezing study area boundaries, the Commission employs a three-prong standard:[11] first, that the change in study area boundaries does not adversely affect the Universal Service Fund ("USF") support program;[12] second, that the state commission(s) having regulatory authority over the exchange(s) to be transferred does not object to the change; and third, that the public interest supports such a change. In evaluating whether the change would adversely affect the USF, the Commission applies a "one percent" guideline to study area waiver requests filed after January 5, 1995.[13] This guideline does not apply in the instant case because Petitioners filed before that date.

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8 47 C.F.R. Part 36, Appendix-Glossary. *See also* 47 C.F.R. § 1.3.

9 *Northeast Cellular Telephone Company v. FCC*, 897 F.2d 1164, 1166 (D.C. Cir. 1990).

10 *WAIT Radio v. FCC*, 418 F.2d 1153, 1159 (D.C. Cir. 1969).

11 *See* US West Communications, Inc., and Eagle Telecommunications, Inc., Joint Petition for Waiver of the Definition of "Study Area" Contained in Part 36, Appendix-Glossary of the Commission's Rules, Memorandum Opinion and Order, 10 FCC Rcd 1771 (1995) (*US West-Eagle Study Area Order*) at ¶ 5.

12 *See 1984 Joint Board Recommended Decision,* 49 Fed. Reg. at 48337, ¶ 66. The Commission created the USF to preserve and promote universal service. *See* Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, 96 FCC 2d 781 (1984). The USF allows LECs with high local loop plant costs to allocate a portion of those costs to the interstate jurisdiction, thus enabling the states to establish lower local exchange rates in study areas receiving such assistance. To determine which LEC study areas are eligible for USF support, the USF rules prescribe an eligibility threshold set at 115 percent of the national average unseparated loop cost per working loop. When loop cost in a particular study area exceeds that threshold, the study area is eligible for support equal to a certain percentage of the loop cost in excess of that threshold. The study area becomes eligible for higher levels of support as its loop cost rises above additional thresholds set farther above the national average unseparated loop cost. Because USF assistance is targeted primarily at small study areas, the level of support provided at each threshold generally is greater if the study area has 200,000 or fewer working loops. *See* 47 C.F.R. § 36.631.

13 The Commission stated that no waiver of the rule freezing study area boundaries should result in an annual aggregate shift in USF assistance in an amount equal to or greater than one percent of the total USF, unless the parties can demonstrate extraordinary public interest benefit. The USF effect for the year must be computed on an annualized basis. To prevent carriers from evading this limitation by disaggregating a single large sale of exchanges into a series of smaller transactions that in the aggregate have the same effect on the USF, the Commission further requires that the "one percent" guideline be applied to all study area waivers granted to either carrier, as a purchaser or seller, pending completion of the current review of the USF program. In this context, the Commission defines the term "carrier" to include all affiliated carriers (i.e., those carriers that are in common control, as the term "control" is defined in Section 32.9000 of the Commission's rules, 47 C.F.R. § 32.9000). *See US West-Eagle Study Area Order* at ¶¶ 14-17.

5. ***Petition.*** According to Petitioners, US West seeks a waiver of the rule freezing study area boundaries to enable it to remove 28 exchanges, which serve approximately 19,365 access lines, from its Washington study area, which serves approximately 2,080,600 access lines. PTI seeks a similar waiver to enable it to add these 28 exchanges to its existing Washington study area, which currently consists of 55 exchanges serving approximately 112,000 access lines. Petitioners further state that all of the transferred exchanges would be operated by Telephone Utilities, a wholly owned subsidiary of PTI.[14]

6. Petitioners assert that these requests are consistent with the original purpose of the USF and that the resulting impact on the USF would be marginal. Petitioners state that US West's Washington study area currently receives no USF assistance and would receive no such assistance after the transfer.[15] PTI estimates that, if the study area waivers were granted, the transfer of the 28 exchanges would result in an increase of $6,198,851 (or approximately 74 percent) in the USF draw of PTI's Washington study area. Such an increase would raise that study area's USF draw from its current level of $8,348,441 to $14,547,292.[16] Petitioners further assert that the proposed change would serve the public interest because Telephone Utilities would improve customer service in the newly acquired exchanges by constructing new digital central offices that would provide the latest signalling technology. Petitioners also assert that PTI has substantial experience in operating rural exchanges similar to the 28 exchanges being transferred. In addition, Petitioners submit that PTI would be able to provide state-of-the-art technology because it has substantial operating experience in such advanced technologies as satellites, digital optical fiber cables and high speed data transmission.[17] PTI estimates that these upgrades would require an investment outlay of approximately $25,000,000 over a five-year period.[18]

7. ***Discussion.*** Petitioners' proposals demonstrate that current and potential customers in the affected exchanges will likely be better served by Telephone Utilities than US West. Petitioners state that Telephone Utilities would install state-of-the-art technology that would enable it to provide enhanced digital services to all customers.[19] We thus believe the transfer of these exchanges, which has been approved by the Washington Utilities and Transportation

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[14] Joint Petition at 1, 5 and Attachment A. We obtained the number of access lines for the Washington study areas of PTI and US West from the National Exchange Carrier Association's Annual USF Report submitted to the Commission in September 1994.

[15] Joint Petition at 6.

[16] PTI Aug. 3 Letter.

[17] Joint Petition at 4-5.

[18] PTI Aug. 3 Letter.

[19] Joint Petition at 5.

Commission,[20] likely will serve the public interest. In addition, we have determined that the increase of $6,198,851 in the USF draw of PTI's Washington study area would not have a significant adverse effect on the USF. We therefore find that the three existing criteria for granting a study area waiver have been met in this instance and that the waiver requests should be granted.

8. Although we find no reason to question PTI's estimates of the USF impact, we nonetheless are concerned that those estimates may later prove inaccurate when the planned upgrades are completed. We have found that, even in a period of a few years, the USF payments for some LECs have risen by unexpected amounts. These LECs generally had undertaken substantial upgrades or expansions of the local network in difficult-to-serve, sparsely populated exchanges that are similar to the exchanges being acquired by Telephone Utilities.[21] Moreover, we are concerned that this sale and a number of similar proposed transactions might, in the aggregate, have a substantial effect on the size of the USF and on those high-cost LECs that draw from the USF.

9. This concern has been mitigated, in the short term at least, by the Commission's adoption of the Joint Board's recommendation for an indexed cap on the USF.[22] Yet, even in the short term, unidentified errors contained in PTI's impact estimates may adversely affect the fund's distribution, if not its size. Under the indexed USF cap rules, any study area reconfiguration that increases the USF draw of one USF recipient reduces that of other USF recipients. Hence, if PTI's estimate proves to be too low, the support provided to other USF recipients could be lowered by an amount that does have a material impact. We therefore find that the waivers should be subject to the condition that the annual USF support provided to the PTI study area shall not exceed $14,547,292, the post-transfer and post-upgrade amount estimated in the PTI

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[20] *See* US West June 12 Letter; Washington Utilities and Transportation Commission Order, Petition of Telephone Utilities of Washington, Inc., d/b/a PTI Communications, for an Order Authorizing the Purchase of Property and for Declaratory Order on Rate Base Treatment, Docket No. UT-940700, released June 7, 1995.

[21] *See, e.g.,* Delta Telephone Company, 5 FCC Rcd 7100 (1990), whose USF payment grew from $82,500 in 1991 to approximately $445,700 in 1993; and US West and Gila River Telecommunications, Inc., 7 FCC Rcd 2161 (1992), whose projection of $169,155 for Gila River's 1992 USF payment was more than doubled by the actual 1992 payment of $390,993, which has been nearly doubled again by the 1995 scheduled payment of approximately $750,000.

[22] The Joint Board recommended, and the Commission adopted, interim rules that will limit the rate of growth of the USF to the rate of growth in the total number of working loops nationwide. That rate of growth has generally ranged from two percent to five percent per year. This moderate growth rate will allow the USF to continue to provide adequate support to carriers serving high-cost areas, while preventing excessive increases in the USF. *See generally* Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, 9 FCC Rcd 334 (1993)("*1993 Joint Board Recommended Decision*"), adopted by the Commission, 9 FCC Rcd 303 *("Interim Cap Order"*). To determine whether permanent changes in the USF rules are necessary, the Commission subsequently initiated a proceeding to address this issue. *See* Notice of Inquiry, CC Docket No. 80-286, 9 FCC Rcd 7404 (1994); Notice of Proposed Rulemaking, CC Docket No. 80-286, FCC 95-282 (released July 13, 1995).

Aug. 3 Letter.[23] The limit imposed by this condition is consistent with PTI's representations as to the expected impact of the proposed changes on the annual USF payments it receives. This condition therefore will ensure that the study area waivers will not result in adverse effects on the USF program that exceed PTI's forecasts.[24]

III. PRICE CAPS WAIVER

10. ***Background.*** Section 61.41(c)(2) of the Commission's rules provides that, when a non-price cap company acquires a price cap company, the acquiring company--and any LEC with which it is affiliated--shall become subject to price cap regulation within a year of the transaction.[25] The Commission stated that this "all-or-nothing" rule applies not only to the acquisition of an entire LEC but also to the acquisition of part of a study area.[26] Hence, under this rule, Telephone Utilities' acquisition of US West's 28 exchanges obligates Telephone Utilities and its parent, PTI, to become subject to price cap regulation instead of rate-of-return regulation.

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23 The imposition of a limit does not imply that the USF draw for PTI's Washington study area will necessarily increase to that level. PTI developed the $14,547,292 estimate by comparing the 1993 nationwide average loop cost to the average loop cost of its Washington study area, assuming that both the transfer and the $25,000,000 of upgrades are already complete. Yet, because the upgrade program is estimated to require five years, the nationwide average loop cost may be substantially higher--due to upgrades by other LECs and inflation--when PTI's upgrades are actually completed. Thus, PTI's estimate is based on cost data that may overstate the amount by which its loop costs will exceed the nationwide average.. Further, under the interim USF rules, a lag of up to two years exists between the time that a LEC incurs additional loop costs and the time that its study area receives additional USF assistance reflecting those higher costs. *See* 47 C.F.R. §§ 36.611-36.612. The existence of this lag time means that the current USF rules may be replaced with new rules, as discussed *supra* at note 22, even before the initial stage of upgrades planned by PTI would cause increased USF payments to the PTI study area. Those new permanent USF rules may alter the method used to determine the distribution of USF support to high-cost areas, thereby changing the projected level of support to the PTI study area.

24 These study area waivers also are subject to the condition that, if the selling LEC is a price cap carrier selling a high-cost portion of its operations, it shall make a downward exogenous adjustment to its Price Cap Index to reflect the change in its study area boundaries. *See* Price Cap Performance Review for Local Exchange Carriers, First Report and Order, CC Docket No. 94-1, FCC 95-132, released April 7, 1995 (*"LEC Price Cap Review Order"*), at ¶¶ 328 and 330. Under that requirement, US West must reduce the Price Cap Index for its Washington study area if the change in study area boundaries reduces the cost basis for that index. The Price Cap Index, which is the cost index on which price-capped rates are based, is calculated pursuant to a formula specified in the Commission's rules for price cap LECs. *See* 47 C.F.R. § 61.45.

25 47 C.F.R. § 61.41(c). *See* Second Report and Order, 5 FCC Rcd 6786, 6821 (1990) and Erratum, 5 FCC Rcd 7664 (1990) (*LEC Price Cap Order*), *modified on recon.* 6 FCC Rcd 2637 (1991) (*LEC Price Cap Reconsideration Order*), *petitions for further recon. dismissed*, 6 FCC Rcd 7482 (1991), *aff'd*, *National Rural Telecom Assoc. v. FCC*, 988 F.2d 174 (D.C. Cir. 1993), *further modification on recon.*, 6 FCC Rcd 4524 (1991)(*ONA Part 69 Order*), *second further recon.*, 7 FCC Rcd 5235 (1992).

26 The Commission explained that, if these two types of acquisitions were not treated the same under the all-or-nothing rule, a LEC could avoid the rule by selling all but one of its exchanges. *See LEC Price Cap Reconsideration Order*, 6 FCC Rcd 2637, 2706.

11. The Commission explained that the all-or-nothing rule is intended to address two concerns it has regarding mergers and acquisitions involving price cap LECs. The first concern is that, in the absence of the rule, a company might attempt to shift costs from its price cap affiliate to its non-price cap affiliate, allowing the non-price cap affiliate to earn more--due to its increased revenue requirement--without affecting the earnings of the price cap affiliate, i.e., without triggering the sharing mechanism. The second concern is that, absent the rule, a LEC may attempt to "game the system" by switching back and forth between rate-of-return regulation and price cap regulation. The Commission cited, as an example, the incentive a price cap LEC may have to increase earnings by opting out of price cap regulation, building up a large rate base under rate-of-return regulation so as to raise rates and, then, after returning to price caps, cutting costs back to an efficient level. It would disserve the public interest, the Commission stated, to allow a LEC to alternately "fatten up" under rate-of-return regulation and "slim down" under price caps regulation, because rates would not fall in the manner intended under price cap regulation.[27]

12. The Commission nonetheless recognized that a narrow waiver of the all-or-nothing rule might be justified if efficiencies created by the purchase and sale of a few exchanges were to outweigh the threat that the system may be subject to gaming.[28] Such a waiver would not be granted unconditionally, however. Rather, similar to certain study area waivers,[29] waivers of the all-or-nothing rule would be granted subject to the condition that the selling price cap LEC shall make a downward exogenous adjustment to its Price Cap Index to reflect the change in its study area. That adjustment is needed to remove the effects of the transferred exchanges from price-capped rates that have been based, in whole or in part, upon the inclusion of those exchanges in the study areas subject to price cap regulation.[30]

13. ***Petition.*** PTI and Telephone Utilities seek waivers of Section 61.41(c)(2) so they may operate as rate-of-return LECs, rather than price cap LECs, after acquiring the 28 exchanges which currently are under price cap regulation. Petitioners argue that the rule's application in this instance is contrary to the public interest and does not serve the purposes for which the rule was adopted. Petitioners further argue that the Commission's two concerns, the threat of cost shifting between affiliates and gaming of the system, are not at issue in this case.[31]

14. ***Discussion.*** We agree with Petitioners that the Commission's first concern underlying the all-or-nothing rule is not applicable in this case. Neither Telephone Utilities nor PTI has an incentive to shift costs between price cap and rate-of-return affiliates, because neither

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27 *LEC Price Cap Reconsideration Order*, 6 FCC Rcd 2637, 2706.

28 *Id.*

29 *See supra* at note 24.

30 *See LEC Price Cap Review Order* at ¶ 330.

31 Joint Petition at 8.

company is seeking to maintain separate affiliates under different systems of regulation. As to the Commission's second concern, we find it implausible that US West could game the system by moving the 28 exchanges back and forth between price caps and rate-of-return regulation, because US West is selling these exchanges and a reacquisition would require a second study area waiver. Moreover, US West cannot transfer the 28 exchanges without removing the rate-increasing effects of these exchanges from the price-capped rates that have been based, in part, upon the inclusion of these exchanges in its Washington study area.[32]

15. We therefore find there is good cause to grant PTI and Telephone Utilities a waiver of the all-or-nothing rule to permit them to remain under rate-of-return regulation after acquiring the 28 exchanges which currently are under price cap regulation. As noted above, these waivers are subject to the condition that US West shall make a downward exogenous adjustment to its Price Cap Index to reflect the removal of these high-cost exchanges from its Washington study area. For the present, we will continue to regulate PTI and Telephone Utilities as rate-of-return carriers. Because we are waiving Section 61.41(c)(2), they need not withdraw from the NECA pools. We note that, as with any other rate-of-return carriers, PTI and Telephone Utilities may elect price cap regulation in the future if they decide to withdraw from the NECA pools.

IV. ORDERING CLAUSES

16. Accordingly, IT IS ORDERED, pursuant to Sections 4(i) and 5(c) of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i) and 155(c) and Sections 0.91 and 0.291 of the Commission's Rules, 47 C.F.R. §§ 0.91, 0.291, that the Joint Petition of US West Communications, Inc., Pacific Telecom, Inc. and Telephone Utilities of Washington, Inc., d/b/a PTI Communications, for waiver of Part 36, Appendix-Glossary, of the Commission's Rules, 47 C.F.R. Part 36 Appendix-Glossary, and for waiver of Section 61.41(c)(2) of the Commission's Rules, 47 C.F.R. § 61.41(c)(2), IS GRANTED subject to the conditions set forth above.

17. IT IS FURTHER ORDERED that NECA shall not distribute USF assistance exceeding the limit imposed in paragraph 9, *supra*.

FEDERAL COMMUNICATIONS COMMISSION

Kenneth P. Moran

Kenneth P. Moran
Chief, Accounting and Audits Division
Common Carrier Bureau

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[32] *See supra* at ¶ 12.

SERVICE DATE

JUN - 7 1995

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of TELEPHONE UTILITIES OF WASHINGTON INC. d/b/a PTI COMMUNICATIONS for an Order Authorizing the Purchase of Property and for Declaratory Order on Rate Base Treatment	DOCKET NO. UT-940700
In the Matter of the Application of U S WEST COMMUNICATIONS, INC. to Transfer Property to Telephone Utilities of Washington, Inc., d/b/a PTI Communications	DOCKET NO. UT-940701 THIRD SUPPLEMENTAL ORDER ACCEPTING SETTLEMENT AND APPROVING SALE OF EXCHANGES

SUMMARY

PROCEEDINGS: On May 20, 1994, Telephone Utilities of Washington, Inc., d/b/a PTI Communications (PTI), and U S WEST Communications, Inc. (U S WEST), submitted filings regarding the conveyance and transfer of twenty-seven local exchanges and/or wire centers. PTI filed a petition seeking an order authorizing the acquisition of assets from U S WEST. U S WEST filed an application for an order approving the transfer of the local exchanges and/or wire centers and associated facilities. The Commission consolidated the petition and application for hearing.

HEARINGS: Administrative Law Judge Alice L. Haenle (ALJ) of the Office of Administrative Hearings conducted a prehearing conference on October 14, 1994. The ALJ convened a settlement conference on January 26, 1995, which was recessed for an indefinite period to permit the parties to engage in the discussion of settlement terms.

APPEARANCES: Petitioner PTI was represented by Calvin K. Simshaw and Deborah J. Harwood, attorneys, Vancouver. Applicant U S WEST was represented by Edward T. Shaw, attorney, Seattle. The Staff of the Washington Utilities and Transportation Commission (Commission Staff) was represented by Gregory J. Trautman, assistant attorney general, Olympia. Robert F. Manifold, assistant attorney general, Seattle, appeared as Public Counsel. Intervenor MCI Telecommunications Corporation (MCI) was represented by Brooks E. Harlow, attorney, Seattle. Intervenor AT&T Communications of the Northwest, Inc. (AT&T), was represented by Gregory J. Kopta and R. Bruce Easter, Jr., attorneys, Seattle, and Susan Proctor,